Is There a Case for Fiscal Stringency in India Now?

C.P. Chandrasekhar and Jayati Ghosh

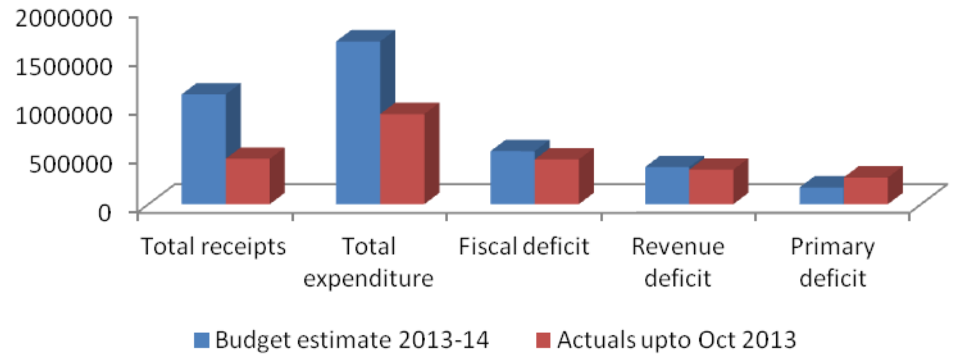
The central government – and more particularly the Finance Ministry - has declared that the government's fiscal situation is so dire that immediate steps must be taken to curb public spending. Accordingly, apparently two measures are to be imposed on all the Ministries and concerned departments. Firstly, they are apparently being told that spending in the last quarter cannot exceed the average of spending in the previous three quarters (contrary to the normal pattern in most government institutions where spending goes up substantially towards the end of the fiscal year). Secondly, they may then be forced to take a further cut on that by around 20 per cent or so.

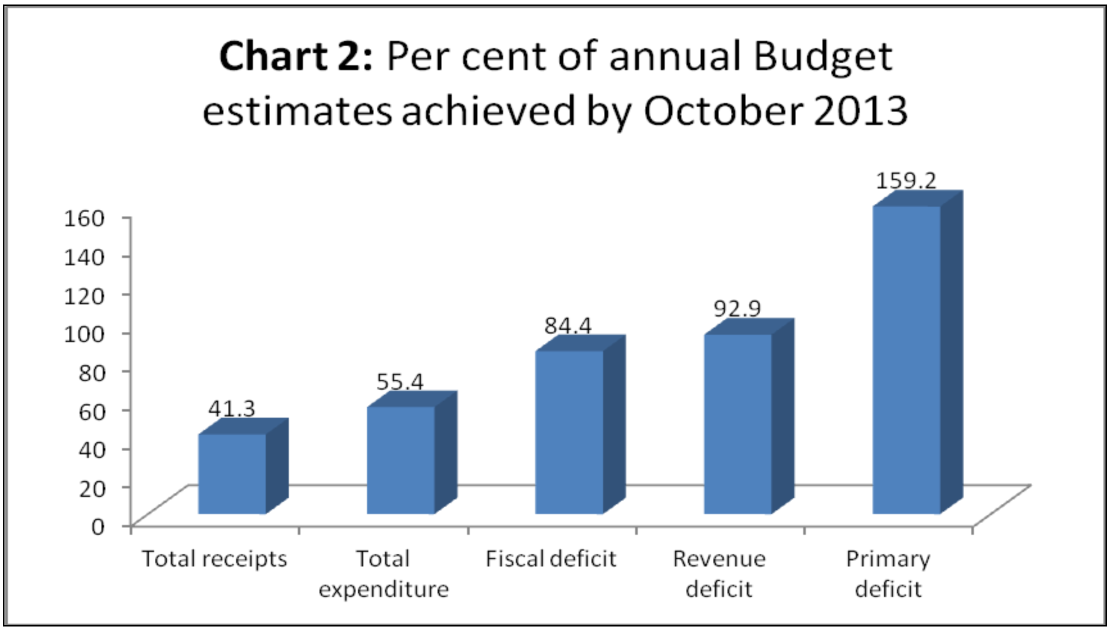
In other words, there are to be sweeping cuts in real terms on spending by all central ministries and departments, regardless of the importance of such spending for the country or for the lives of the people. This particular strategy is not new, of course. Something similar was imposed by the Finance Ministry in the previous year, but that was in a context of economic slowdown from which the same government is now claiming recovery.

So how bad exactly is the situation? Does it require such extreme and even panic-stricken measures? Chart 1 shows the Budget Estimates of 2013-14 compared to the actual numbers from April to October 2013, and this does seem to indicate a problem. It is evident that after seven months of the fiscal year, the gap between receipts and expenditure has grown quite substantially compared to the budget estimates of the full year.

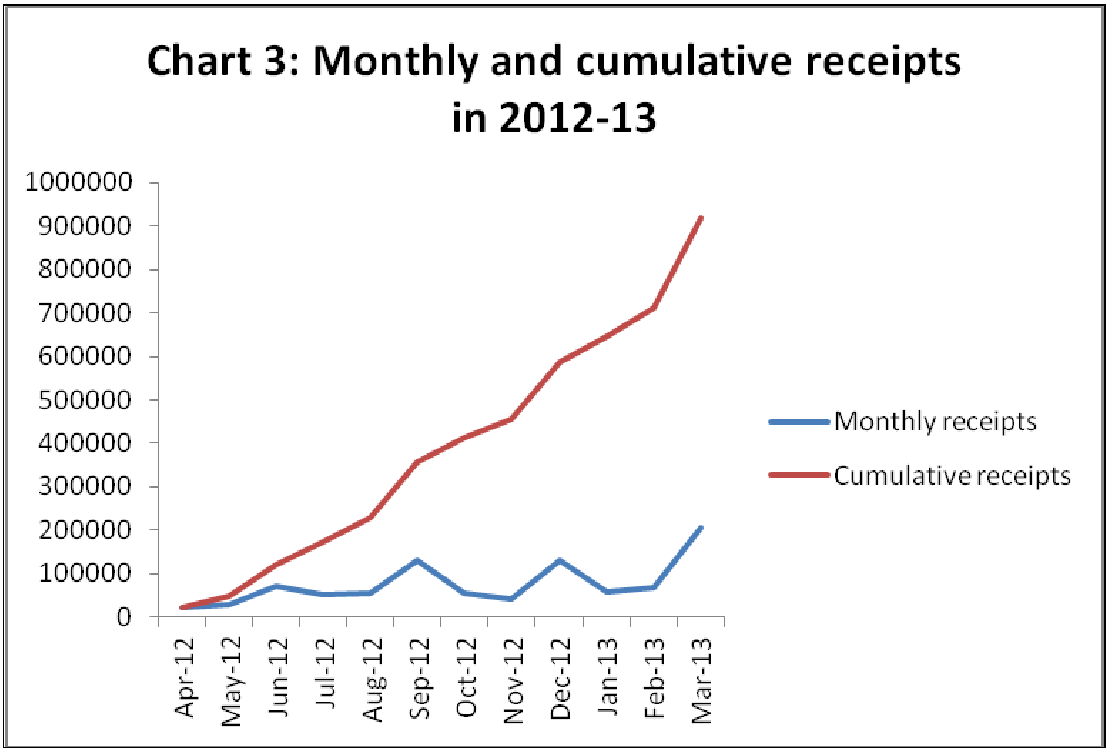
This becomes even clearer from Chart 2. Thus total receipts until October 2013 were only 41 per cent of the budget estimates but expenditure is already more than 55 per cent of the budget estimates. As a result, the fiscal deficit is already 84 per cent of the expected deficit for the entire fiscal year, and the revenue deficit is 93 per cent of that expected. The primary deficit (leaving out interest payments) is more than one and a half times what it is expected to be for the entire year.

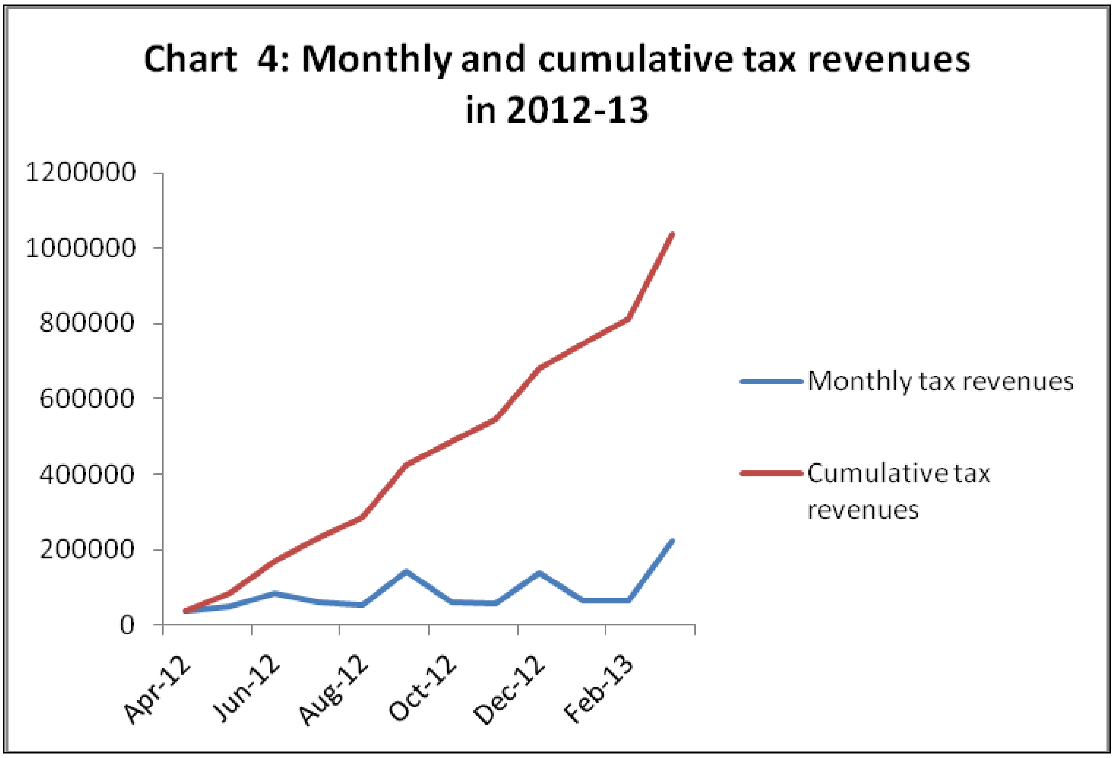
Chart 1: Budget estimates versus Actuals upto October 2013 (Rs crore)



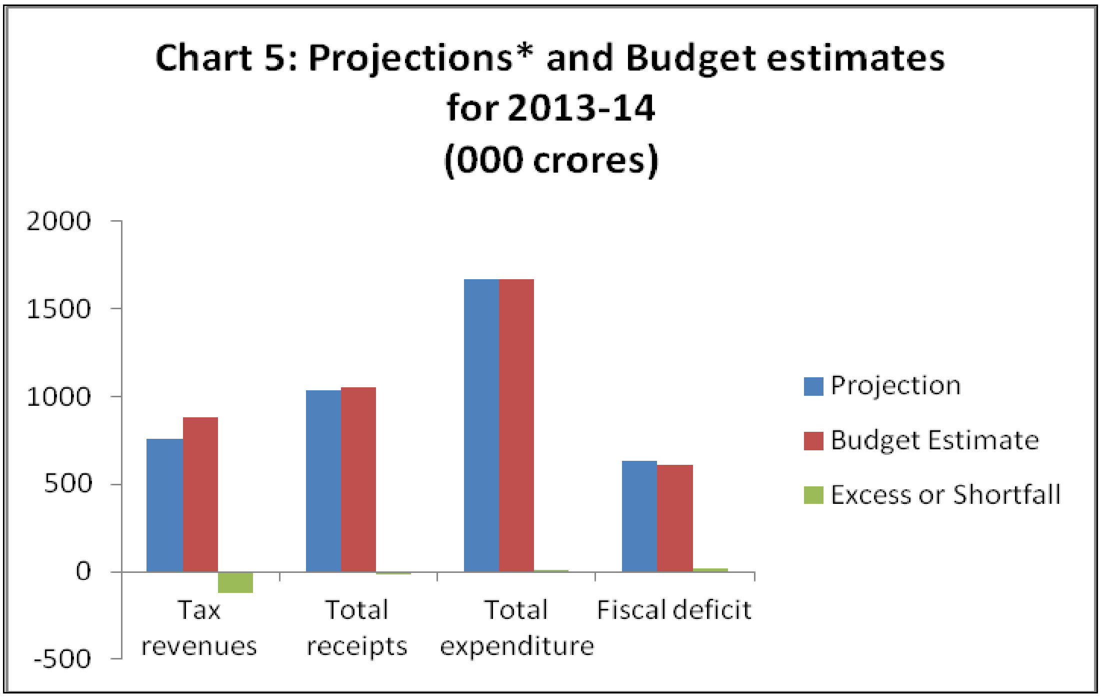


However, that would be a somewhat misleading way of looking at the issue. In fact, it is well known that both revenues and expenditure fluctuate quite significantly over the course of the fiscal year. Particularly revenues accrue in discontinuous fashion, for example, with quarterly payments, as is shown in Chart 3. This is especially the case with tax revenues, which tend to increase very sharply in the last few months of the year and especially in the last month of the fiscal year when many direct tax collections occur.





This suggests that the likely tax receipts for the financial year would be much higher than a simple extrapolation of the receipts thus far. In fact, it makes more sense to project the future receipts and expenditure for the current fiscal year on the basis of the known pattern that has been evident in previous years. Therefore, Chart 5 provides estimates based on the pattern that prevailed in 2012-13 in terms of both revenues and expenditure. The ratio of the revenues for April-October 2012 relative to the total revenues for the fiscal year 2012-13 is taken as the relevant ratio to project the full year's revenues for 2013-14 based on revenues for April-October 2013. The same is done for expenditures. This yields the results illustrated in Chart 5, which provide a much more reassuring estimate of expected deficits.



Thus, while tax revenues are likely to be lower than the budget estimates, total receipts will not be quite as low. The projected fiscal deficit according to this is likely to be only marginally higher than expected, at an excess of around Rs 21,000 crore, which is easily manageable. Certainly this is not a situation that calls for emergency measures of the type that are being proposed.

It may be objected that this ignores the problem of controlling the fiscal deficit relative to GDP, which is the ratio that everyone (and worst of all, foreign investors and the dreaded "markets" look at). And it is true that real GDP growth is likely to be lower than was projected at the time the budget was passed. But since the ratios are relative to nominal GDP (which includes inflation) and inflation has unfortunately been much higher than expected, that ratio too is unlikely to be very different from what was projected.

But there is a further, and possibly much more significant, concern with this kind of arbitrary decision by the Finance Ministry to cut spending across the board, even in areas that directly affect the lives of people and thereby impact on them adversely. Citizens of India are being told that the central government does not have the money to fulfill its commitments to the people and that even important expenditure on health, sanitation, education and other public services will be cut in the last quarter of the fiscal year.

This is not only unnecessary (as has been shown above) but also highly objectionable. There is a good reason why Budgets must be passed by Parliament and why that is the single most important vote for the government to enable it to survive and have the authority to govern. The Constitution explicitly mandates the democratic oversight of the raising of resources and spending by government, and the underlying principle for this is that resource raising and spending patterns of the government must be subject to popular scrutiny, through the elected representatives in this case. .

If the government decides on its own to cut expenditure – and if this includes the spending that should be considered as essential for the social and economic rights of the people – this amounts to not just bypassing parliament but actually defying both democracy and the Constitution.

This means that we cannot allow the central government to decide on its own that money for critical items of public spending for the people will not be made available. If adequate revenues have not been raised, the government must answer for it and explain why measures to improve the situation have not been taken. And the decision of what expenditure to cut must be an open transparent process that is also known to the people.

*** This article was originally published in The Business Line on December 9, 2013.**